standard is that, before an RBOC should be allowed to enter long distance, it must be able to demonstrate that its market is truly open (which, I should make clear, is different from saying its market is fully competitive). Before I put meat on the bones of that standard, let me first say how we think it integrates with the remainder of Section 271. We believe that the other provisions -- the checklist, the facilities-based requirement, the separate-subsidiary requirement, and the option of Track B -- are all necessary, though not sufficient, to support entry. These requirements, almost as their names imply, involve fixed points but, by themselves, are not sufficiently dynamic to ensure that real competition can take place. That's where we think our approach comes into play: we view it as the dynamic part of the equation, looking to ensure that the wholesale support systems for opening up local markets are not simply claimed to be in place, but that they will actually work in fact, are scalable, and have been benchmarked, so that competition will be real and not merely theoretical. We think this approach is the best way to ensure competitive effectiveness, which we take to be our express charge under the statute, and we think it dovetails nicely with the "public interest" standard that the FCC is charged with applying in making the ultimate decision under 271 whether to approve a particular application. More broadly, we believe that our approach fits well within the overall statutory scheme adopted by Congress, nicely blending the fixed and dynamic requirements to reach an effective result.

Now, let me add a few words about how we will apply this standard to RBOC applications under Section 271 of the Act. Our preference, though we recognize that it may not always occur, is to see actual, broad-based -- i.e., business and residential -- entry into a local market. This kind of entry requires not only appropriate agreements between the RBOCs and their potential competitors, but also the wholesale support systems necessary to ensure that when a current customer is switched from the RBOC to the new competitor, the switching process occurs quickly and effectively, so that the customer is satisfied and its new phone company is not blamed for messing up the transfer -- or that, after a customer has been switched and she needs any services, such as repair of her phone line, she gets it from the RBOC in a timely and effective manner. The truth is that, no matter how effectively systems are designed and even assuming complete good faith on the part of the RBOC, this kind of transition can have a lot of bugs in it. Once we see successful full-scale entry, however, then we will have reason to believe that the local market is open to competition. This approach doesn't require the shift of any particular amount of market share; nor should it take very long once there is true broad-based entry into the RBOC's market. Rather, using a metaphor that I've become quite fond of, we just want to make sure that gas actually can flow through the pipeline; and the best way to do that is to see it happen.

This approach -- i.e., looking for tangible entry -- also has two additional virtues: first, once there is such entry, the new entrant certainly should have an incentive to make the process work, since any new customers that are ill-served will blame the new entrant. This will mean that the new entrant is not likely to be gaming the system and, if there are problems, the reason will be that the local market, for some real-world reason -- malign or benign -- just isn't ready for competition yet. And second, if broad-based competition appears to be working smoothly, as we certainly hope it does, it will establish a benchmark against which future, post-RBOC entry into long distance, performance can be measured. In other words, if competitors can obtain what they need, and what they are legally entitled to get, from the RBOC prior to its entry into long distance, but not after it, then we will have reason to suspect that something is wrong and we will be able to pursue appropriate remedial action.

Now, an even harder problem arises when the RBOC claims that it's done everything it can to make entry opportunities fully available but, for some reason, no new entrant has decided to go forward in a significant way. In these circumstances, we will attempt to determine what the problem is. And, purely at the level of speculation, one could imagine a variety of explanations. For example, the prices being charged by the RBOC could be too high to allow effective competition any time soon or its systems may be too uncertain for the new entrant to take the risk of large-scale entry, or the RBOC may not be cooperating with its competitors by providing the necessary wholesale support systems. On the other hand, it may be that, despite reasonable interconnection terms, fully available support systems, and so on, it simply may not make economic sense for a new entrant to come into any given market on a large-scale basis. Or, a more elaborate version of this problem may be that, if the long distance carriers think they are better off preventing the new competition by the RBOC in their market and also think that the best way to achieve this result is to stay out of the local markets, they may simply choose not to enter. On the third hand, if you will, it may be that some other factor -- such as a state statute or local regulation -- is making large-scale entry infeasible or, at least, very unattractive. These are some possibilities, and I'm sure there are others as well.

In any event, we will carefully examine the facts in any case where there isn't full-scale entry to determine what's actually going on. In such circumstances, of course, we will ultimately have to make a fact-based determination on a case-by-case basis. But I want to be very clear about one thing: we will pay careful attention to see whether any party is trying to game the system for its own parochial reasons. And, if we think that's what's going on, be assured that we'll take appropriate action. We don't have any dog in this fight -- just a desire to ensure full-scale competition in telephony in an enduring fashion. Once that occurs, the market can pick the winners and losers.

Let me now quickly turn to the last couple pieces of this deregulatory puzzle -- access reform and universal service. These areas, which are related, also raise long-term competitive concerns. Lowering access charges to cost is desirable in a competitive market but, in the process, there are at least a couple of things you need to be alert to -- first, you want to ensure that no one gets an undue competitive advantage during the transition process; and second, you need to make sure that the incumbent LEC is fairly compensated for any implicit subsidies in the system that it has to bear and which have previously been supported by above-cost access charges. That is where the universal service funding system kicks in. It is designed to pick up these kinds of subsidies so that, as I said earlier, competition can go forward without unfairly burdening those players that have to bear the costs of such subsidies.

These kinds of issues can be enormously complex -- first, how do you sort out implicit subsidies as well as any historic costs that a LEC is entitled to recover in a way that is fair; and, second, how do you then collect the money necessary to pay these costs through a competitively neutral system. If you've seen the FCC's Notice of Proposed Rulemaking on Access Charges -- a rulemaking that is ongoing as we speak -- you probably have some idea of how complicated this whole process is. The Commission has raised important questions about rate structure, about rate levels -- including possible market-based as well as prescriptive methods for dealing with these levels -- and about rate de-averaging, which means allowing different access charges for different customers. Anyway, the trick is to do this in a way that hastens competitive opportunities but that is fair to all parties. I am confident that the Commission will do just that.

One final point to remember as we move into a deregulated environment is that the

Telecom Act explicitly keeps the antitrust laws in force. This serves not only to guard against any anticompetitive consolidation, but also against any other practices that violate the antitrust laws. Once regulation begins moving off center stage, we are prepared for the possibility that antitrust enforcement may be necessary to ensure full and fair competition in these markets. Especially in network industries, questions of exclusive dealing, control over essential facilities, and the use of market power can raise significant antitrust concerns. As a result, I intend to make sure that the Division keeps fully abreast of the developments in the marketplace and is ready to take any action necessary to prevent abuses of market power or other anticompetitive practices.

Let me close by emphasizing that, while I've tried to accurately portray at least some of the difficulties set in motion by last year's Telecom Act, I'm very optimistic about the endeavor we have embarked upon. I've seen some recent stories in the press complaining that consumers haven't yet received the benefits of the 1996 Act but, frankly, I think such expectations are unrealistic. We've had a regulated system of telephony in this country for over a century; it won't be deregulated in a year and even after it is deregulated, it'll take time for competition to ring all the fat out of the system so that consumers truly get the best service at the lowest prices. But, if we stay the course, I'm confident that we will ultimately realize how wise this legislation was and how much it will benefit our people. I say that because history has taught us, time and time again, that deregulation is difficult and transitions can be costly, but if our Nation's economy is to be as strong as it can be -- indeed, as strong as it must be in an increasingly globalized market -- deregulation is not only desirable, it's essential. In short, history is on our side. A little patience is all that's needed.

6

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

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|---|---|---|
| UNITED STATES OF AMERICA,<br><br>Plaintiff,<br><br>v.<br><br>WESTERN ELECTRIC COMPANY, INC. and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,<br><br>Defendants. | ) | Civil Action No. 82-0192 HHG |

MEMORANDUM OF THE UNITED STATES IN RESPONSE
TO THE BELL COMPANIES' MOTIONS FOR GENERIC WIRELESS WAIVERS

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July 25, 1994

The theoretical model on which Southwestern relies depends, in general, on the presence of many key and restrictive conditions, at least *four* of which are not present here. First, as Southwestern Bell acknowledges, the theory is limited to unregulated monopolists. Cellular duopolists are not universally unregulated; in California, home of 20 percent of the nation's population, cellular prices are regulated.[31] Second, the theory requires that the two inputs (here, cellular service and long distance service) be used in fixed proportions; if the integrator or user can vary the proportions (by making more or fewer long distance calls) the general argument fails. Third, the argument does not apply where the firm cannot price discriminate in the downstream market -- the long distance market -- without vertical integration. Fourth, and most important, the argument applies only to the situation in which a monopolist is integrating with a firm in a competitive market; here we have decidedly imperfect competition in cellular, and (as the BOCs acknowledge) imperfect competition in long distance. The "one monopoly rent" model does not speak to the situation of integrating oligopolists.[32]

The theory embraced by Southwestern argues that there are no means (except efficiency means) by which monopolists can vertically integrate and increase their monopoly profits. *See* R. Bork, *The Antitrust Paradox*, at 229. That theory has been rejected by economists of all persuasions, who recognize that there are conditions under which a

[31] Cal. Pub. Util. Code § 401 *et seq.*; 17 CPUC 2d 499 (1985) In California, "the Public Utilities Commission has jurisdiction over rates charged for cellular service." *Cellular Plus, Inc. c. Superior Court*, 18 Cal. Rptr. 308, 311 (1993). Cellular carriers must file financial statements, receive approval for wholesale rate increases, and receive approval to install new transmitter sites. *See also* BOC Mem. 28 ("half of the States do not regulate cellular or paging providers at all"; the other half presumably do, even if they "typically impos[e] no price regulation at the retail [*i.e.*, reseller] level"). Regulation of BOC landline exchanges further distorts the "one monopoly rent" argument.

[32] Carlton & Perloff 517, 510.

7

# DEPARTMENT OF JUSTICE

STATEMENT OF

ANNE K. BINGAMAN

Assistant Attorney General

Antitrust Division

BEFORE THE

SUBCOMMITTEE ON

ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS

SENATE JUDICIARY COMMITTEE

UNITED STATES SENATE

CONCERNING

S. 1822

THE COMMUNICATIONS ACT OF 1994

PRESENTED ON

SEPTEMBER 20, 1994

telecommunications markets, which both S. 1822 and the House legislation well recognize.

Cable television and local telephone service are the most obvious markets where more competition is necessary. Both are currently monopolized by existing providers, prompting government regulation to protect consumers from excessive rates. Yet even though the technological advances I have just mentioned may make it possible for competition to erode these monopolies and thus end or relax current regulation, government regulations still inhibit this competition. In particular, existing law, at varying levels of government, frustrates providers of cable and local telephone services from offering both services, in full competition with each other, in the same service territories.

Second, while several competitors certainly have made significant inroads in long-distance telephone markets, there is room for more competition. AT&T still has about 60% of long-distance traffic.

Third, while telephone equipment is now probably the most competitive of the markets affected by the MFJ, even this market could use additional competition. Here, too, AT&T continues to have a leading share of the market, although it faces stiff competition from numerous other providers, domestic and foreign. Given their expertise in the industry, some or all of the RBOCs may be natural entrants into developing and manufacturing telecommunications equipment, especially for network switching, but are precluded from entry by the MFJ. Under the right terms and conditions, entry by the RBOCs into these activities could help spur innovation and bring down prices for telecommunications equipment. In the process, the RBOCs could help make American firms even more competitive in the international telecommunications equipment market.

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The Richmond Times Dispatch

December 8, 1996, Sunday, CITY EDITION

SECTION: BUSINESS, Pg. E-1

LENGTH: 1135 words

HEADLINE: DEREGULATION FAILS TO STOP RISING LONG DISTANCE RATES

BYLINE: Paula Squires

BODY:

Some people will pay more to give friends and relatives a jingle during the holidays.

Right before the season of good will began, the country's three largest carriers boosted basic rates on residential long-distance service, prompting protests from consumer advocates and Bell Atlantic Corp.

AT&T Corp., the nation's leading long-distance company, announced its largest price increase in three years, 5.9 percent, the day before Thanksgiving. It took effect Dec. 1.

Its chief competitor, MCI Communications Corp., boosted its rate 4.9 percent Dec. 1.

Sprint Corp. already had increased rates by 2 percent or 3 percent in November, depending on the distance of the call.

Talk about being a grinch.

''I would think a lot of people are amazed to see such big rate increases at a time when they've been told that the market is going to become more competitive,'' said Jean Ann Fox, a vice president for the Virginia Citizens Consumer Council who follows utility regulation.

Whatever happened to the competition and lower prices consumers were told to expect with deregulation of the telecommunications industry?

Like Santa's reindeer, the effects of deregulation are waiting in the wings, poised for flight but grounded at the moment.

Before local phone service providers can enter the long-distance market, the Telecommunications Act of 1996 requires competition in local telephone markets. In many states, including Virginia, plenty of companies have applied to provide local service. Arbitration on pricing agreements with regional telephone companies such as Bell Atlantic is progressing, although at a slower pace than some had expected.

The result: consumers lose, at least for now. Many still have the same number

of long-distance choices, but pay more for basic long-distance service.
In a letter to Federal Communications Commission Chairman Reed E. Hundt, Bell Atlantic Chairman Raymond W. Smith urged speedier admission of regional telephone companies into the long-distance market.

''You and I know that Bell Atlantic and the other Bell telephone companies will bring real competition to long-distance, which will lead to lower rates,'' he wrote.

Basic rates for AT&T, MCI and Sprint are nearly identical and have been moving in only one direction, up, in the past couple of years.

Since 1994, AT&T has raised its basic rate four times, by 7.7 percent in January 1994, 3.7 percent in December 1994, 4.3 percent in February 1996 and this month's 5.9 percent boost.

This year alone, MCI has boosted rates twice, 4.9 percent in February and 4.9 percent again this month.

Company officials say increases are needed to offset promotional costs, investments in new technologies and additions to infrastructure. The timing of the most recent batch of increases is purely coincidental, they add, and was not meant to capitalize on the traditionally heavy volume of long-distance calls placed during the holidays.

''Actually the heaviest call day of the year is Mother's Day,'' said Brad Burns, a spokesman for MCI.

Besides, company officials say, the increases don't affect many consumers who take advantage of discount plans.

''It only affects about 25 percent of our customers,'' Burns said.

At Sprint, a majority of customers subscribe to Sprint Sense, a flat rate plan not affected by the increase. Under the plan, people pay 10 cents a minute during the week from 7 p.m. to 7 a.m. and during all weekend hours. The rate is higher for weekly daytime hours -- 25 cents a minute.

The story is a little different at AT&T. The majority of its 85 million customers will be affected by the 5.9 percent rate boost, with the average monthly bill increasing 60 cents, said company spokesman Mark Siegal.

''From where I sit, 60 cents a month is not very much,'' Siegal said.

The company also increased rates by 5 percent for calling card calls and 2.6 percent for calls assisted by an AT&T operator.

The rate changes don't affect customers on AT&T's new One Rate plan. Introduced two months ago, it offers a flat, 15 cent-per-minute rate, 24 hours a day, on long-distance calls within the United States.

Rates on overseas calls are also unchanged.

However, customers on discount plans, such as True Reach, are affected, Siegal explained. While discounts remain in force, they're coming off a higher basic rate.

Siegal views the long-distance market as fiercely competitive. Companies are offering discount plans and cash promotions, and preparing to enter local and wireless markets, all in a bid to win and keep customers.

''In a competitive environment, you must recover costs. There's simply no choice,'' Siegal said.

As for Bell Atlantic's protest, Siegal said: ''We look forward to competing with them. I think they're going to have a harder time than they think.''

In Virginia, GTE Corp., which already serves some local areas, began offering long-distance service in June. The publicly held telecommunications company with headquarters in Stamford, Conn., offers telephone service in 28 states. It is exempted by federal law from the lengthier procedures required for the regional Bells to enter long-distance markets.

According to company spokeswoman Barbara Bellinghausen, GTE is signing up about 6,000 customers a day. ''We have over 600,000 now and expect to hit three-quarters of a million by the end of the year,'' she said

The company's rates are competitive with current long-distance carriers, she said. GTE offers a savings plan based on how much consumers spend a month on long-distance. If someone spends $ 25 a month, they get a 25 percent discount; $ 10 dollars a month brings a 10 percent discount. ''Most of the customers who call during off peak hours pay about 10 cents a minute,'' Bellinghausen said.

Plus, she says, customers have the benefit of getting one bill for both local and long-distance service.

That's the wave of the future: a single bill from a telecommunications company that can offer everything -- telephone service, cable TV and Internet access.

But we're not there yet.

READER'S FILE

The three major long-distance carriers boosted rates in 1996 for basic residential long-distance service. Here's a breakdown of the companies and the rate increases:

AT&T Corp.

February, 4.3 percent.

December, 5.9 percent.

MCI Communications Corp.

February, 4.9 percent.

December, 4.9 percent.

Sprint Corp.

Nov. 1, 3 percent.

Nov. 18, 2 percent.

Note: These increases apply to two separate mileage bands (the distance a call must cover), with one band getting the 3 percent boost and the other the 2 percent raise.

If you have consumer concerns, write Paula Squires, Richmond Times-Dispatch, P.O. Box 85333, Richmond, Va. 23293. Her e-mail address is tdbiz£prodigy.com

LOAD-DATE: December 10, 1996

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Los Angeles Times

November 30, 1996, Saturday, Home Edition

SECTION: Business; Part D; Page 3; Financial Desk

LENGTH: 365 words

HEADLINE: YOUR MONEY;
MCI RAISING RATES WITH RIVALS

BYLINE: From Bloomberg Business News

DATELINE: NEW YORK

BODY:

MCI Communications Corp., the nation's second-largest long-distance company, is raising rates along with AT&T Corp. and Sprint Corp. as the companies try to boost profits ahead of wide-open competition in the U.S. phone market.

AT&T had said earlier this week that it will raise basic long-distance rates by 5.9%, effective Sunday, to cover increased costs for customer service and for enhancing its phone network to handle services such as new calling programs and Internet access. MCI had also filed with the Federal Communications Commission to boost rates 4.9%, also on Sunday, a spokesman said Friday.

Sprint Corp. raised rates by 2% earlier this month, also in an FCC filing.

The moves come as the long-distance carriers prepare for competition from deep-pocketed regional Bells in the $ 70-billion-a-year U.S. long-distance market, and try to stave off smaller competitors.

"It's an opportunity to pad margins a bit," said Brian Adamik, a telecommunications analyst at the Yankee Group, a Boston research firm. "Carriers are bulking up before a possible price war" when the long-distance market has more and bigger companies involved.

Adamik says he expects long- distance rates to rise 10% to 15% before the Baby Bells get into the market, which may not happen until 1998.

AT&T's rate increase could raise the average phone bill of a customer by 60 cents a month, the company said Wednesday.

AT&T shares rose 25 cents to close at $ 39.25. MCI rose 25 cents to $ 30.50 and Sprint rose 25 cents to $ 41.875.

The rate increases, the largest in recent years, will mainly affect customers who aren't already on an AT&T or MCI discount-calling program. They also come at the start of the busiest calling season--the weeks between Thanksgiving and New

Year's Day.
AT&T's rate hike actually follows that of MCI, which filed with the FCC for its increase on Nov. 1 without announcing it publicly.

Analysts said AT&T and MCI can get away with the price increases because many of their customers, who are charged basic rates, don't examine their bills as closely as those who choose discount plans, and are the ones least likely to switch long-distance carriers.

LANGUAGE: English

LOAD-DATE: November 30, 1996

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IAC (SM) Newsletter Database (TM)
Telecom Publishing Group
Report On AT&T

February 26, 1996
SECTION: No. 5, Vol. 14; ISSN: 0741-8361

LENGTH: 344 words

HEADLINE: AT&T BUMPS UP RATES BEFORE RBOC LONG-DISTANCE ENTRY

BODY:

On the heels of legislation that will increase long-distance competition, AT&T is increasing interstate residential rates. It is the company's first rate hike in more than a year, and officials say it needed to do so to align AT&T's prices with the cost of providing the service.

But analysts say the move is more than a measure to cover costs. By raising rates now, AT&T will have more play in their rates when the regional Bell operating companies (RBOCs) enter the game.

"The long-distance carriers are pricing-up in preparation for RBOC entry into long-distance. Long-distance carriers now are taking advantage of the opportunities to increase pricing while fully expecting these prices to go down when the RBOCs enter long-distance," Brian Adamik, an analyst with the Yankee Group in Boston, told The Report On AT&T.

Adamik said the RBOCs most likely will position price as a major component their marketing plan. After negotiating a good price from the facilities-based carriers, and adding in marketingcosts, they still will be able to hit the streets with a very attractive offer.

And the interexchange carriers will lose that competitive edge if they don't have that pricing flexibility upon RBOC entry, Adamik said.

Residential rates have been on the increase since 1992, Adamik told RATT. So now is the perfect time to hike up those rates. AT&T and MCI cut their savings plans last year.

Adamik expects MCI and Sprint will follow suit.

Sprint said late last week that it too would be increasing basic residential rates by 5 percent. Its Sprint Sense rates for off- peak hour increased from 22 cents per minute to 25 cents. A spokesman said only that the rates were raised due to the "additional cost pressure that all interexchange carriers face."

At press time, MCI had not announced any residential rate hikes.

Perhaps as a little trade-off, AT&T also renewed its True USA Savings and True Savings discount plans for existing customers. These programs were set to expire in the first quarter.

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UNITED STATES DISTRICT COURT FOR

DISTRICT OF COLUMBIA

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| UNITED STATES OF AMERICA,<br>Plaintiff,<br>vs.<br>WESTERN ELECTRIC COMPANY, INC., AND AMERICAN TELEPHONE AND TELEGRAPH COMPANY,<br>Defendants. | ) | Civil Action No. 82-0192 |

CITY OF WASHINGTON )
) ss.
DISTRICT OF COLUMBIA )

<u>Reply Affidavit of Professor Jerry A. Hausman</u>

JERRY A HAUSMAN, being duly sworn, deposes and says:

1. My name is Jerry A. Hausman. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139. My qualifications were given in my original affidavit filed in this proceeding in July 1994.

2. In this affidavit I reply to a number of claims contained in submissions of parties opposing the removal of the long distance and equipment manufacturing restrictions on the Bell Operating Companies. (BOCs) I have not responded to each and every argument contained in the over one thousand pages of submissions, but I have addressed all of the submissions which disagree with my economic analysis of the long distance and equipment markets. None of the material submitted has caused me to change my opinion that BOC entry into the long distance and equipment markets is very likely to have a pro-competitive effect.

## I. INTERLATA LONG DISTANCE

### A. Competitive Conditions in Long Distance

3. Professors Glenn Hubbard and William Lehr (HL), in an affidavit submitted on behalf of AT&T, claim that no significant barriers to entry exist in interLATA long distance: "In the current long-distance industry, there are no significant barriers to entry. Indeed, there has been substantial entry both before and increasingly following divestiture." (Aff. of R.G. Hubbard and W.H. Lehr, p. 6) They make this claim with respect to the costs of "creating a national facilities-based network to compete with existing carriers". The basic economics of this claim are wrong.

4. Modern economic theory recognizes significant sunk costs of entry and exit to be among the main causes of barriers to entry. Sunk costs are costs which are invested in a market but cannot be recovered if the firm decides to exit the market.[1] Construction of a national facilities-based network requires sinking a fiber optic network into the ground. When a firm makes an entry decision in this situation of significant sunk costs, it must be convinced of the long term profitability of entry because it cannot recover its investment if the entry decision turns out to be unprofitable.[2]

5. The mistake that HL make is elementary: they fail to recognize that current incumbents in long distance will react to new entry. HL state that, "if prices were sufficiently above their competitive levels, additional entry would occur."[3] What they fail to realize is that this additional entry, if

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[1] This definition agrees with the classic Stigler approach (The Organization of Industry, Homewood, IL, 1968, p. 67) to barriers to entry since existing firms have already sunk the costs, which cannot be recovered, but a new entrant has to invest the sunk costs in order to enter the market.

[2] Other AT&T affiants, Prof. Baumol (p. 14, p. 18) and Prof. Bernheim and Willig (p. 4) recognize the importance of "substantial sunk investments" as a barrier to entry in local exchange markets. These same required sunk investments provide a barrier to entry in long distance markets.

[3] Another AT&T affiant, Prof. Baumol, contradicts this incorrect claim by HL: "It is true that excessive profits always make a field more attractive to prospective entrants; but so long as substantial barriers to entry remain, such prospects will continue to constitute little more than wishful thinking...." (p. 21)